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FINANCIAL MARKETS DEPARTMENT

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

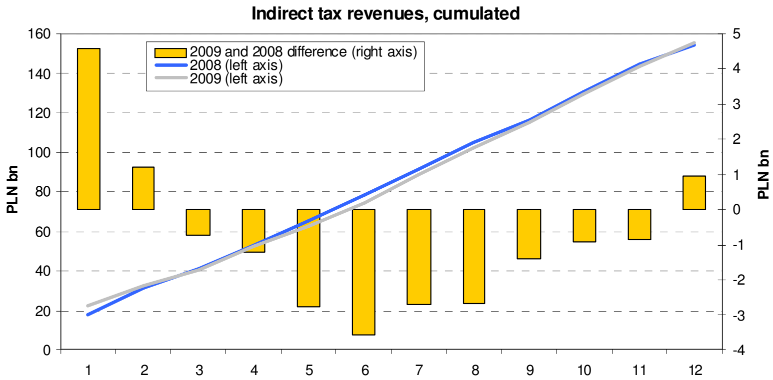
PREVIEW: The week of February 5th 2010 to February 11th 2010

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
NO SIGNIFICANT RELEASES						

In Focus / Macroeconomics

The flow of positive fiscal news

This week Polish FinMin finally released the data on 2009 budget performance (on cash basis). The deficit amounted to PLN 23.8bn, i.e. 88% of the plan (after mid-year amendment). Better budget deficit figure is to be attributed to an acceleration in tax revenues. In December 2009 VAT revenues were by 30% higher than a year ago (the growth rate is affected by low base effect, though). The cumulated indirect tax revenues in 2009 proved to be higher than in 2008 as well. Less impressive are the PIT and CIT revenues, which only show signs of stabilization. This notwithstanding, stronger momentum in tax revenues makes it more likely that 2010 budget revenues will exceed the official budget estimates based on a pretty conservative assumption of a 1.2% GDP growth.



Another positive fiscal news was directly related to the newest convergence report, which Polish government has to submit to Brussels on a yearly basis, and new upbeat growth forecasts. The information agencies have reported that the government based its fiscal consolidation plan (to be included in the convergence report) on GDP growth rates of 3.4% in 2010, 4.5% in 2011 and 4.0% in 2012. Those forecasts, though not unrealistic, are more optimistic than the market consensus and should naturally translate into lower estimated net borrowing needs (also the press information), which are to drop from above PLN 80bn to PLN 57bn. The gross borrowing needs are thus not to top PLN 170 bn, which is the level close to that of 2009. The 2010 fiscal projections are also close to our earlier estimates based on 3%+ GDP growth forecast. It has to be stressed, however, that those estimates have not been included in the Convergence Report, where the government stuck with the 2010 budget deficit figure of 7% of GDP and sees positive fiscal effect only materializing in 2011 and 2012; there is only a brief statement of the central budget deficit – due to conservative budget assumptions it may fare better than assumed PLN 52.2 bn.

The third positive factor were the comments by Mr. Almunia, who claims that Polish fiscal reforms are on track. However, the market did not really take notice of the details and the fact that Almunia praised the plan submitted on January 7. by Minister Rostowski in a letter note, and not the final version which was not ready yet on that time. As the coalition Peasants Party cast many doubts on some issues of the fiscal consolidation plan (mainly the issues connected with farmer pensions reform), the official document will present somehow a consensus-blunted view. In our opinion that is why the Ministry of Finance allowed the growth forecast to "leak out" – it was one of the easiest ways to make fiscal consolidation path (reducing budget deficit in 2012 to below 3.0% of GDP) more credible.

The update of the fiscal convergence plan is backed up with only 5 important points from the fiscal reform and consolidation plan, excluding any significant changes in the pension system (to this point, junior coalition party leader has its own proposals including lump sum pension contribution).

1) Expenditure rules. The rules are aimed at curbing excessive growth of public expenditures in order to bring general government deficit to 3% within a reasonable horizon (to be specified in

the upgrade of the convergence plan). The more restrictive rule limits to growth of expenditures to real 1%. As soon as the deficit reaches 3%, the rule is to be changed to a more neutral and more supportive to the other automatic stabilizers (from definition automatic stabilizer is anti-cyclical) i.e. the growth of expenditures will be limited by the mean GDP growth rate in the preceding 5-6 years. The idea seems reasonable, although the scope of eligible expenditures is very limited for now (about 25% of all government outlays).

2) Better management of financial flows within the government sector. So far the various ministries managed their accounts separately which made the whole sector artificially unbalanced (some ministries had surpluses, some shortages with no possibility of clearing the balance). The proposal aims at managing the funds on a central level, eliminating thereby the need to cover temporary shortages in various sectors by debt emission. The resolution is planned to generate PLN 0,2bn of savings and limit the public debt level by at least PLN 10bn in 2010.

3) Changes within the presentation of public obligations. The Ministry proposes not only to present public debt figures as a whole but also to isolate the pension system obligations. Such a proposal is expected to rise transparency of the public debt and may be a prelude of Polish lobbying in favor of such a resolution within the other EU countries. On the other hand it is useful excuse to escape the consequences of fiscal thresholds (50%, 55%, 60%) as public debt excluding pension obligations (the debt issued to transfer cash to open pension funds) is way below 50%.

4) Changes in pension schemes regarding the police employees and other public services (including military) of this sort. Non-negligible effects of the change are likely to be seen no sooner than in 20 years time.

5) Speeding up the privatization process. No surprise on this field. The plan expect PLN 25 bn of privatization revenues this year (so far the Ministry of Treasury successfully sold more than PLN 2bn of state assets this year).

MID-TERM FORECATS

Indicator	2007	2008	2009	2010	2011
GDP y/y (%)	6.5	4.8	1.7	3+	4.5
Inflation rate (%, average)	2.4	4.3	3.5	2.3	2.9
Current account (% of GDP, average)	-4.5	-5.3	-1.3	-2.3	-3.7
Unemployment rate (end-of-year)	11.4	9.5	11.9	**12.1**↑	**10.9**↑
NBP repo rate (end-of-year)	5.00	5.00	3.50	4.00	5.50

Indicator	2009				2010	
	Q1	Q2	Q3	Q4	Q1	Q2
GDP y/y (%)	0.8	1.1	1.7	3.0	3.8	3.3
Inflation rate (%, average)	3.2	3.7	3.5	3.5	3.3	2.1
NBP repo rate (end-of-quarter)	3.75	3.50	3.50	3.50	3.50	3.50

Bold denotes chages from the last release with arrows showing the direction of chages

Fixed Income

Déjà vu.

Last week we saw again very nice volatility on the market. 5y bonds marked new highs in terms of price, we saw some interest to receive PLN IRS against EUR. The biggest impact on the curve had very impressive buying by international banks, as we saw huge inflow into PLN bonds accompanied with massive strengthening of EURPLN. Prices touched highs, yet again, just ahead of auction. The general sentiment looks to change very much depending on current market focus. While all the local story has been positive (better GDP, fiscal story) the external news tend to weight on the market a lot (especially on Thursdays … for whatever reason). Wednesday afternoon and Thursday morning market gapped. We saw good supply especially in 5y and 10y bonds, curve has become a little steeper and ASW widen 2-5 bp. The total move in 1019 (Thursday to Thursday) was 150 cents (90 up and 60 down) with volumes at this year highs. This time around it was not Greece, it was Portugal. Summing up, past week we had seen 1) record inflows into Polish bonds, 2) Ministry of Finance selling record amount of bonds, 3) external factors cause strong and volatile sell off. Exactly the same pattern as previous week. Range.

Our view is unchanged. We stick to the plan we outlined 2 weeks ago. Tight spreads, good liquidity and high volatility offer plenty of opportunities for investors. So far, selling rallies and buying 10y bonds on dips have worked better than buy-and-hold strategy…Turning to a bit longer horizon, we still see 20y bonds to fall in yield and stick to the idea of 2y2y rates decline, but see clearly more risk for such a scenario.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6,142%	2008-12-09
26 Week T-bills	-	-	4,456%	2009-05-04
52 Week T-bills	2010-02-08	-	3,838%	2010-02-01
2Y T-bond OK0712	2010-02-10	-	5,052%	2010-01-13
5Y T-bond PS0415	2010-02-10	-	5,736%	2009-12-02
10Y T-bond DS1019	2010-02-19	-	6,046%	2009-05-20
20Y T-bond WS0429	2010-02-19	-	6,170%	2009-09-23

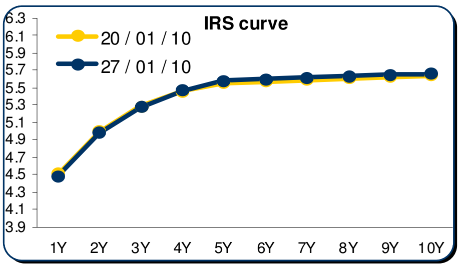
Money Market

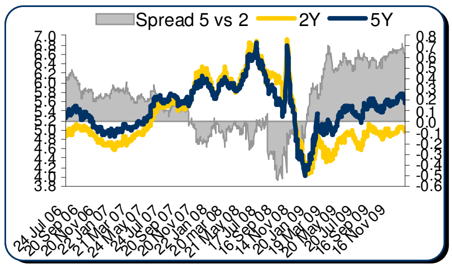
NBP will pool the repo amount starting next week

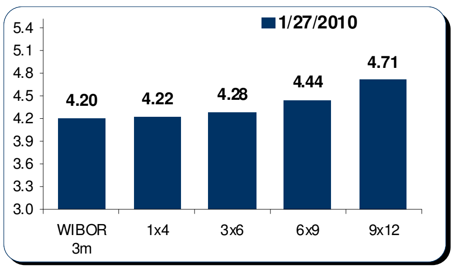
Over- liquidity of the system will still be large

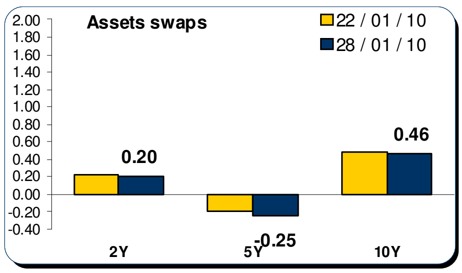
New reserve requirement settlement period started quietly. Despite of the squared system, the shortest rates were being quoted below the 3% level. The OIS curve went up by 20 bps for 6M and longer, due to the central bank's announcement in which they informed about pooled repo starting next week. Just to remind, so far all demand has been satisfied during repo auctions. Now it is going to change and the central bank will start showing the cash amount to be repoed out. Depending on the offer it can either remain without any influence for the market (large pools) or will make the participants fight for cash increasing the cost of this OMO. If we consider over PLN 60 billion, which is currently invested in money bills, we really think that whatever happens with repo it will not decrease the liquidity of the system much (as of now only PLN 16 billion comes from the previous repo auctions). Worst case scenario is falling amount of the money bills in the system, which is not bad at all. Therefore, we think that market overreaction to this information might be reflected in falling polonia ois contracts from 6 to 12M. Moreover bullish sentiment for other interest rate pln products (good fiscal information, stronger currency, impressive demand during bond and T-bills auctions) also support the scenario.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

EUR/PLN downtrend confirmed

Finally, Zloty has managed to break the psychological support at 4.000. The stop loss buying of polish currency, and the fresh flows into zloty, dragged the EUR/PLN to 3.9550 (new low). At this level , the move went out of steam, and with sourer global sentiment (Greece, Portugal) we have experienced the very swift correction back to 4.0375. In our opinion we are in the EUR/PLN downtrend with consecutive lower lows and lowers highs; only the break of 4,1250 will cancel this view.

Implied volatility wobble

The EUR/PLN gamma was in demand once the 4.000 has been broken. It could be an effect of the triggered barrier at 4.0000 that forced same of the "barrier holders" to buy back the gamma on the market. The short term implied volatility (1week) has jumped about 2.0% as an effect. One year USD/PLN ATM was traded at 17.75% , 6 months at 17.50% and the currency spread USD/PLN vs EUR/PLN has widened to 6% mid (0.4% higher vs last week).

Short-term outlook

SPOT

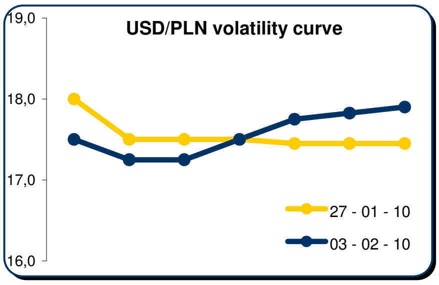
Main supports / resistances:
EUR/PLN: 4.8500 / 4.1250
USD/PLN: 2.8000 / 3.9500

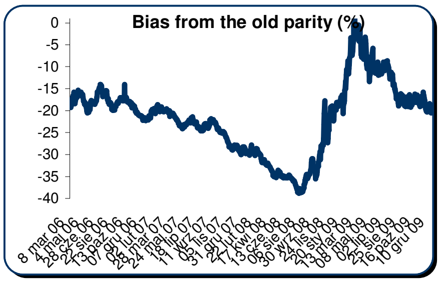
The world turbulences will persist but in our opinion the uptrend in Zloty is intact. The correction will be stopped probably at 4.0550/4.0750. Strong resistance at 4.1250, strong support at 3.900.

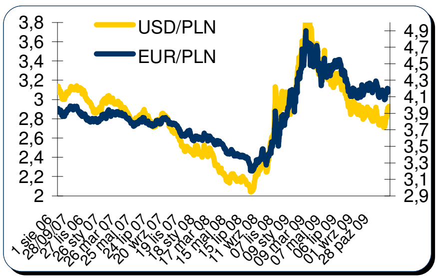
OPTIONS

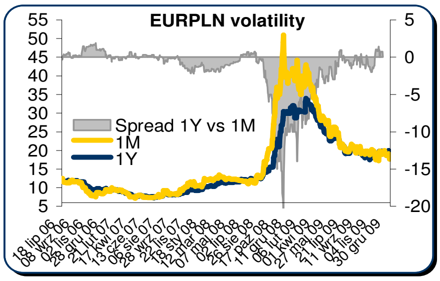
We think the implied volatility market on zloty is now more driven by huge flows then any specific logic or idea. The historic volatility is being supported only by a few big observations but in general remain low. We see Vega edging lower (due to our positive Zloty view) and Vanna higher.

FX CHARTS









MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)

date	3M FXSW	3M WIBOR	6M FXSW	6M WIBOR	1Y FXSW	1Y WIBOR
28-01-10	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?
29-01-10	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?	6,59%
01-02-10	#NAZWA?	#NAZWA?	#NAZWA?	6,49%	#NAZWA?	#NAZWA?
02-02-10	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?
03-02-10	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
28-01-10	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?
29-01-10	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?
01-02-10	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?
02-02-10	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?
03-02-10	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?	#NAZWA?

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y WIBOR	1Y TB	2Y IRS	2Y OK0709	5Y IRS	5Y PS0511	10Y IRS	10Y DS1017
28-01-10	#NAZWA?	3,76%	4,98%	4,69%	5,58%	5,34%	5,65%	6,15%
29-01-10	6,59%	3,70%	4,92%	4,66%	5,52%	5,30%	5,60%	6,09%
01-02-10	#NAZWA?	3,70%	4,89%	4,63%	5,49%	5,24%	5,59%	6,05%
02-02-10	#NAZWA?	3,71%	4,88%	4,62%	5,50%	5,24%	5,58%	6,04%
03-02-10	#NAZWA?	3,67%	4,95%	4,62%	5,55%	5,24%	5,62%	6,04%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	10-02-01	11-02-01	96,264	3,84%	1200	3848	1200
OK0712	10-01-13	12-07-25	88,260	5,05%	6600	23000	6600
PS0415	09-12-02	15-04-25	98,691	5,78%	5000	5614	3629
DS1019	10-01-20	19-04-25	96,009	6,05%	2000	6596	2409

FX VOLATILITY

date	USD/PLN 0-delta stradle 1M	3M	6M	1Y	25-delta RR 1M	1Y	25-delta FLY 1M	1Y
28-01-10	17,25	17,25	17,25	17,25	2,00	3,25	0,80	0,85
29-01-10	17,25	17,25	17,25	17,25	2,00	3,25	0,80	0,85
01-02-10	17,25	17,25	17,25	17,25	2,00	3,25	0,80	0,85
02-02-10	17,25	17,25	17,25	17,25	2,00	3,25	0,80	0,85
03-02-10	17,25	17,25	17,25	17,25	2,00	3,25	0,80	0,85

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
28-01-10	2,8957	4,0630	-20,27%
29-01-10	2,9083	4,0616	-20,23%
01-02-10	2,8787	4,0250	-20,45%
02-02-10	2,8603	4,0035	-20,14%
03-02-10	2,8321	3,9849	-18,80%

Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50

Mid-market volatility of vanilla option strategies

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